

Specification:

BACKGROUND OF THE INVENTION--FIELD OF INVENTION:

Please replace the description with the following sentence.

This invention relates to providing coverage for loss expenses ~~when a separate contract of insurance is in force~~ that are difficult or impossible to insure.

BACKGROUND OF THE INVENTION:

For the section titled Loss Definition and Valuation, please replace all the paragraphs after the first paragraph with the following five paragraphs.

To be eligible to receive insurance payments, insurance buyers must be able to prove that they had losses and that those losses fit within the coverage definition of their insurance. Losses can be categorized in many different ways such as life, health, property, casualty, etc. More generally, losses can be categorized as being direct or ~~collateral~~ indirect.

A direct loss is ~~essentially the loss itself~~ a loss where the insured peril is the proximate cause of the loss. ~~A collateral loss, sometimes referred to as an indirect or consequential loss, is engendered by the same event that produces the direct loss or by the direct loss itself.~~ For example, the direct loss of a factory due to a fire would be the cost of rebuilding the factory. The ~~collateral indirect~~ losses would be all of the costs associated with the inconvenience of not having a workable factory. Direct losses, such as the physical cost of the buildings in this example, are typically much easier to estimate than ~~collateral~~ indirect losses such as lost income or extra expenses that may result from such an event.

Management and employees must spend time trying to recover from this event, and there is always a significant amount of opportunity cost that can never be adequately assessed.

Consider for example the loss of an automobile. Since it is a physical thing, it should be obvious that there was a loss and the extent of that loss. Nevertheless, the ~~collateral~~ indirect costs (for example lost time and other expenses) associated with fixing or replacing the car and the opportunity costs of not having a working car are not typically covered by

insurance. Similarly, insurance may cover the direct cost of paying for and defending against a liability claim, but it typically would not cover the costs necessary to restore an entity's reputation via an advertising program or to institute new practices and procedures.

~~While collateral~~ Indirect losses vary in size depending on the specifics of the loss, ~~it is clear that~~ but they occur with every type of insurable loss. Although insurance can cover certain limited types of indirect costs such as the loss of income (business interruption) and "extra" or "expediting" expenses that are necessary to return a business to normal after a loss, ~~In most cases,~~ companies and individuals are not typically insured against ~~collateral indirect~~ losses because these losses are often too difficult to define in advance or prove after the fact to make an insurance transaction economically viable ~~for both insurers and insurance buyers.~~

Furthermore, policyholders often have considerable discretion over ~~collateral~~ indirect losses, making them impossible to quantify and subject to significant moral hazard. Since ~~collateral indirect~~ losses are becoming an ever larger part of most companies' loss experience, it is no wonder that companies are increasingly frustrated with insurance.

For the section titled Loss Definition and Valuation, please add the following two new paragraphs to the end of this section.

One consequence of having a large loss is that an entity's future insurance premiums may increase. Since this additional cost is not subject to the discretion of the insured, it is relatively easy to finance. To the extent that an insured is interested in purchasing this kind of coverage, an insurance company could just charge some extra amount of premium to smooth the eventual cost of the premium increase. This financing mechanism is similar to a heating oil company that charges its customers more than it would otherwise charge in the summer, when oil prices are lower, and less than it would otherwise charge in the winter. This smoothes the price variation of oil so customers can more accurately budget for their heating cost.

For clarity, we are defining "collateral losses" to be a subset of indirect losses that have not been covered by insurance because they are subject to the discretion of the insured.

Collateral losses arise from insured events but are too difficult to define, prove, or measure to be covered by an insurance policy in the traditional way. Collateral losses include but are not limited to such things as: lost income, lost productivity, credit losses, additional borrowing costs, reputation maintenance expenses, claim expenses, accounting expenses, legal costs, consulting, and other types of discretionary expenses.

For the section titled Agreed Value, please replace the last two paragraphs with the following three paragraphs.

Inventory or cargo insurance is another example of where this principle has been applied to direct losses. With inventory it is generally accepted that different types of companies have incurred costs that are greater than the purchase price of the goods they own. From an economic perspective, the value is not the invoice cost but the replacement cost of the inventory at a particular stage in the production, transportation, and retailing process.

Rather than dispute this point, insurers and insureds often agree to a stated percentage above the purchase price of the goods. Under this arrangement, the insurer and the insured increase the limit of the insurance to some commercially reasonable amount, and the price of this coverage is increased to take account of the higher loss valuation.

Thus, if the insured chooses to buy this extra coverage in an amount of 10% and has a loss, the insured will be paid the invoice amount for the goods that were lost plus an additional 10%. In this example, it is easy enough to define the potential losses in advance and to prove those losses after the fact, but the use of the agreed value principle helps eliminate the expense of having to measure the loss.

For the section titled Transaction Costs, please replace the third paragraph with the following paragraph.

Furthermore, it is not unusual for there to be disputes about what ~~was covered, after a loss has occurred,~~ the cause of a loss was or if it is covered by insurance, and many claimants initiate litigation proceedings against their insurers to force them to pay. The

inability to define in advance all the losses that will be covered by the policy makes it difficult for the insurance buyer to assess the value of the insurance policy and makes it equally hard on insurers to determine a fair premium.

BACKGROUND OF INVENTION-OBJECTS AND ADVANTAGES:

Please replace the first paragraph of this section with the following paragraph.

The object of the invention is a method and process for financing expenses associated with insured loss events that we call Secondary Loss Expense Coverage. This method provides a new way to finance indirect loss expenses that are currently ~~either expensive or impossible to insure such as most types of collateral losses including such things as claim, administrative, management, accounting, legal, reputation maintenance, loss of income due to productivity impairment and other types of expenses.~~ It also makes it possible to insure collateral losses that are too difficult to define, prove, or measure to be covered by an insurance policy in the traditional way.

DRAWINGS—FIGURES:

Please replace this section with the following description.

Fig 1 shows ~~the relationship between a Secondary Loss Expense Contract and an underlying insurance policy and outlines the various parties to these contracts~~ a Secondary Loss Expense Contract that bears a functional relationship between its premiums and the premiums paid for an insurance policy as well as a functional relationship between the losses that are recovered under the two contracts.

Fig 2 is a chart and a table that demonstrates the relationship between ~~Secondary Loss Expense Coverage and an insurance policy as well as the cost and benefits of this coverage~~ a 30% Proportional Secondary Loss Expense Contract and an insurance policy and shows the costs and benefits of this coverage.

Fig 3 is a flowchart that demonstrates how simple and cost effective it is to perform underwriting and loss adjustment functions ~~using Secondary Loss Expense Coverage, even for loss expenses that are hard to define or prove~~ when a Secondary Loss Expense Contract bears functional relationships to the premiums of the underlying insurance policy and the losses recovered under that policy.

DETAILED DESCRIPTION--FIGS 1 - 3--PREFERRED EMBODIMENT

Please replace the first two paragraphs of the section titled Product Overview with the following three paragraphs.

~~An overview of the relationship between a Secondary Loss Expense Contract and insurance policy is shown in Fig 1.~~ Fig 1 shows how a Secondary Loss Expense Contract's premiums and loss payment may be related to the premiums paid for and the losses recovered under an insurance contract. It also shows the various parties to these contracts. An insured 4 has an insurance policy 6 with an insurer 8. The insurance policy may have one or more coverage parts and may specify various deductibles, retentions, limits, coinsurance, and exclusions. A ~~coverage~~ loss protection buyer 10, also referred to as the coverage buyer or buyer, may be the insured or another entity that has an interest in the well-being of the insured, such as a customer of the insured. The coverage buyer may desire to buy loss protection via the Secondary Loss Expense Contract 12.

The Secondary Loss Expense Contract has two pre-specified functional relationships to the insurance policy: the contract's ~~losses~~ loss payment 14 ~~are~~ is a mathematical function of the losses that are recovered under one or more coverage parts of the insurance policy; and the contract's premiums 16 are a mathematical function of the ~~insurance policy's~~ premiums paid for one or more coverage parts of the insurance policy. Although this relationship may be expressed in many different ways, it must give the buyer value and allow a loss protection seller 18, also referred to as the coverage seller, to make money.

The loss payment of the Secondary Loss Expense Contract may exclude certain types of losses that are recoverable under the insurance policy it references and may specify

additional deductibles, retentions, and limits. The loss protection seller 18 may be the same as the insurer 8 or may be some other entity that is interested in providing Secondary Loss Expense Coverage.

Please replace the first paragraph of the section titled Cost/Benefit Analysis with the following paragraph.

Fig 2 shows an example of Secondary Loss Expense Coverage and illustrates its cost and benefits in relation to an insurance policy. In this example, an insured is concerned about insured losses that might range from \$0 to \$1000. The insured recognizes that there are likely to be collateral losses that are uninsurable over this range of loss experience and would like to obtain coverage for them if possible. The insured has three choices.

- a. Buy no insurance and suffer losses as they occur.
- b. Purchase an insurance policy for a premium of \$30 that contains a deductible of \$50 and an insured limit of \$1000.
- c. Buy the insurance policy and supplement it by purchasing Secondary Loss Expense Coverage equal to 30% of the insurance policy. This would cost 30% of the insurance policy's premiums, or an additional \$9, and would pay 30% of any losses that are recovered under the insurance policy.

The graph in Fig 2 shows the net cost or benefit of each of these options over the relevant range of loss experience. The total cost or benefit equals the loss amount minus premiums and deductibles, plus any insurance and any Secondary Loss Expense Coverage ~~recovers~~ loss payments.

Please replace the first paragraph of the section titled Method of Underwriting and Loss Adjusting with the following paragraph.

The flowchart in Fig 3 illustrates how an entity that desires to sell Secondary Loss Expense Coverage could use this business method to eliminate most of the work that is currently required to underwrite loss coverage and to adjust claims. First, a coverage seller creates two functional relationships 20. One relationship defines the losses ~~covered~~ paid by

Secondary Loss Expense Coverage in terms of the losses that will be recovered under one or more coverage parts of an insurance policy, and the second relationship defines the premium of the Secondary Loss Expense Contract in terms of the premiums paid for one or more coverage parts of an insurance contract. ~~Next, the coverage seller communicates its willingness to offer coverage on these terms to potential buyers 22. For example, the following schedule might be used to communicate that the coverage seller is willing to provide Secondary Loss Expense Coverage on a basis that is proportional to the coverage and price of the underlying insurance.~~

Please insert the following six new paragraphs after the first paragraph of the section titled Method of Underwriting and Loss Adjusting.

Defining loss coverage involves three decisions. First, one must specify the insured loss payments on which the Secondary Loss Expense Coverage will be based. This involves specifying one or more coverage parts of an insurance policy and any types of losses paid within these coverage parts that will be excluded from the Secondary Loss Expense Coverage.

Exclusions may be based on the cause of loss such as a hurricane, terrorism, earthquake, etc. Losses may be excluded because they did not occur in conjunction with some particular type or cause of loss. They may also be based on the relationship of loss payments from different coverage parts of an insurance policy. For example, one might specify that there will be no Secondary Loss Expense payment unless there is a payment made under a particular coverage part of the insurance policy to which it refers. Exclusions may be based on many other factors as well.

Second, one must define the relevant range of the Secondary Loss Expense Coverage by specifying any deductibles, retentions, and limits that will restrict the amount of this loss payment. Third, one must specify the mathematical function that will be used to determine how much the Secondary Loss Expense Coverage payment will be for a given amount of loss over this relevant range.

This mathematical function may be structured so that the Secondary Loss Expense Coverage is proportional or nonproportional to the losses specified within the relevant range. This coverage is proportional if it specifies a percentage of Secondary Loss Expense Coverage for every dollar of insured loss recovery within the relevant range. For example, one might specify that the Secondary Loss Expense Coverage payment will be 10% of a particular property insurance policy's payments made under Coverage A, excluding losses from hurricanes, less a \$5,000 deductible, and subject to a limit of \$5 million.

Nonproportional Secondary Loss Expense Coverage may specify a binary relationship, i.e. if there are insured loss recoveries within the relevant range a particular sum of money will be paid. Alternatively, nonproportional Secondary Loss Expense Coverage may be scaled based on the size of the insured losses recovered within the relevant range. For example, one might specify loss coverage that pays nothing for the first \$100 thousand of specified insurance loss recoveries, pays 10% of insurance loss recoveries between \$100 thousand and \$1 million, and then pays 20% of insurance loss recoveries subject to a limit of \$2 million loss coverage.

Having developed loss payment and premium relationships based on one or more coverage parts of an insurance policy, the coverage seller uses some means of communicating this information about its willingness to offer coverage on these terms to potential buyers ²². This could be communicated via an intermediary, a telephone, radio, mail, the internet, or any other means of communication. For example, the following schedule might be used to communicate that the coverage seller is willing to provide Secondary Loss Expense Coverage on a basis that is proportional to the coverage and price of the underlying insurance.

Please replace the paragraph Additional Embodiments with the following paragraph.

Although the basic methodology for Secondary Loss Expense Coverage remains the same as described above, there are numerous embodiments of this concept. This method can be applied to all types of insurance policies including property, casualty, health, and ~~life insurance coverages~~, life, disability, workers' compensation, etc. ~~Secondary Loss~~

~~Expense Coverage can be offered by both primary insurers and third parties such as other insurers, banks, or other types of entities. Furthermore, Secondary Loss Expense Coverage can be offered in the form of an insurance policy or take many other contract forms. Secondary Loss Expense Coverage may be offered in amounts that are directly proportional or indirectly related to the premiums paid and the losses that are recovered from an underlying insurance policy.~~

Please add the following three new paragraphs to the section titled Additional Embodiments.

Insurers may use this method to write a new policy or an endorsement to an existing policy so as to provide their customers with additional loss coverage. However, this method also permits entities that are not involved in the original insurance policy to offer this coverage. Other insurers, banks, or other types of companies may find it advantageous to offer this type of coverage. Moreover, this method enables companies to provide loss coverage in the form of an insurance policy or any other type of contract.

Secondary Loss Expense Coverage offers tremendous flexibility in defining mathematical functions that can be applied to insured loss payments. This function can be based on the losses paid on one or more coverage parts of an insurance policy and can limit such coverage further by specifying additional exclusions, deductibles, retentions, and limits. Having specified the insured loss payments and a relevant range over which the Secondary Loss Expense Coverage applies, one can then create mathematical functions that bear all types of proportional and nonproportional relationships to the relevant range of specified insured loss payments.

Also, Secondary Loss Expense Coverage lends itself to many different business models. One might predefine acceptable combinations of loss payments and premiums and communicate this information to potential buyers so as to substantially reduce transaction expenses. However, this is not necessary to make Secondary Loss Expense Coverage valuable and worthwhile. Coverage sellers could just indicate their willingness to offer this

type of coverage, and set their premiums on a case by case basis.

Please replace item j. of the section titled Advantages with the following item j.

j. Gives insurance buyers access to new sources of capital by permitting third parties without insurance licenses to offer them coverage;